Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
The Commission's Cable Horizontal and Vertical Ownership Limits	)	MM Docket No. 92-264
	)	
Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992	)	CS Docket No. 98-82
	)	
Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996	)	CS Docket No. 96-85
	)	
Review of the Commission's Regulations Governing Attribution of Broadcast and Cable/MDS Interests	)	MM Docket No. 94-150
	)	MM Docket No. 92-51
Review of the Commission's Regulations and Policies Affecting Investment in the Broadcast Industry	)	
	)	MM Docket No. 87-154
Reexamination of the Commission's Cross-Interest Policy	)	

FOURTH REPORT & ORDER AND
FURTHER NOTICE OF PROPOSED RULEMAKING

Adopted: December 18, 2007 **Released: February 11, 2008**

Comments due: (30 days after date of publication in the Federal Register)
Reply Comments due: (45 days after date of publication in the Federal Register)

By the Commission: Chairman Martin, Commissioners Copps and Adelstein, issuing separate statements; Commissioners Tate and McDowell, dissenting and issuing separate statements.

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I. INTRODUCTION

1. In this *Fourth Report and Order*, we set the Commission's cable horizontal ownership limit to prohibit cable operators from owning or having an attributable interest in cable systems serving more than 30 percent of multichannel video programming subscribers nationwide. Our decision implements the statutory directive that we impose a limit designed to ensure that no single cable operator or group of operators, because of its size, can unfairly impede the flow of programming to consumers.[1] Our action also responds to the court's concerns in *Time Warner Entertainment Co. v. FCC* ("*Time Warner II*"), that the Commission had failed adequately to justify the 30 percent limit.[2]

2. In establishing the 30 percent cable horizontal ownership limit, we rely on a modified "open field" approach to ensure that no single cable operator becomes so large that a programming network can survive only if that operator carries it. To calculate a horizontal limit that meets this test, we first determine the minimum number of subscribers a network needs in order to survive in the marketplace and then estimate the percentage of subscribers a network is likely to serve once it secures a

[1] 47 U.S.C. § 533(f)(2)(A).

[2] *Time Warner Entertainment Co. v. FCC*, 240 F.3d 1126 (D.C. Cir. 2001) ("*Time Warner II*").

carriage contract. The resulting calculation indicates that an open field of 70 percent and an ownership limit of 30 percent are necessary to ensure that no single cable operator is able to impede unfairly the flow of programming to consumers.

3. In the *Further Notice of Proposed Rulemaking*,[3] we seek further comment on (1) whether to retain the single majority shareholder attribution exemption, which currently applies to the cable and broadcast ownership rules; (2) whether, under the cable attribution rules, a limited partner may sell programming to the partnership and retain insulation; and (3) whether the Commission should clarify certain aspects of the cable Equity Debt ("ED") attribution rule, as it did for the broadcast Equity/Debt Plus attribution rule.[4] We also invite comment in the *Further Notice* on an appropriate channel occupancy limit, because the record evidence so far is inadequate to allow us to set such a limit.

II. FOURTH REPORT & ORDER

A. Background

4. The Cable Television Consumer Protection and Competition Act of 1992 ("1992 Cable Act") amended the Communications Act of 1934 ("Act" or "Communications Act") to promote increased competition in the cable television and related markets.[5] The 1992 Cable Act added structural rules intended to address the consequences of increased horizontal concentration and vertical integration in the cable industry.[6] Section 613(f) of the Act, added by the 1992 Cable Act, directs the Commission to conduct proceedings to establish reasonable limits on the number of subscribers a cable operator may serve ("horizontal limit") and the number of channels a cable operator may devote to its affiliated programming networks ("vertical," or "channel occupancy" limit).[7] A principal goal of this statutory

[3] This is the Second Further Notice of Proposed Rulemaking with respect to certain aspects of our attribution rules and the Third Further Notice of Proposed Rulemaking with respect to the channel occupancy limit.

[4] We ask that commenters submit comments regarding issues raised in the *Further Notice of Proposed Rulemaking* only in MM Docket No. 92-264, MM Docket No. 94-150, and CS Docket No. 98-82. We terminate MM Docket Nos. 87-154 and CS Docket No. 96-85. MM Docket No. 87-154 concerned the Commission's previous cross interest rules, which have long since been eliminated and replaced in part by the bright-line EDP attribution rule. The issues raised in MM Docket No. 87-154 have either been resolved or have been incorporated into MM Docket No. 94-150, the Commission's broadcast attribution review proceeding. *See 1995 Broadcast Attribution Notice*, 10 FCC Rcd 3606, 3612-12 ¶¶ 9-10 (1995). In CS Docket No. 96-85, the Commission initiated a rulemaking to amend its rules to implement provisions from the Telecommunications Act of 1996. The issues addressed in that rulemaking proceeding are unrelated to the matters addressed in this *Report and Order* and *Further Notice* and either have been resolved or incorporated into separate proceedings. *See Implementation of Cable Act Reform Provisions of Telecommunications Act of 1996*, CS Docket No. 96-85, *Order on Reconsideration*, 17 FCC Rcd 7609 (2002). Accordingly, in the interest of administrative efficiency, we are terminating these two proceedings. MM Docket No. 92-51 generally reviewed the Commission's policies affecting investments in the broadcast industry and sought comment on how attribution affects capital investment and new entry. While most of the issues raised in the proceeding were incorporated in MM Docket No. 94-150, there may be outstanding issues that have not been resolved. Therefore, we are severing MM Docket No. 92-51 from this proceeding.

[5] Cable Television Consumer Protection and Competition Act of 1992, Pub. L. No. 102-385, 106 Stat. 1460 ("*1992 Cable Act*"); H. R. REP. NO. 102-628 (1992) ("*House Report*"); Communications Act of 1934, 47 U.S.C. §§ 151, et seq. ("*Communications Act*").

[6] *Id.* § 613(f), 47 U.S.C. § 533(f).

[7] *Id.* ("In order to enhance effective competition, the Commission shall . . . conduct a proceeding . . . to prescribe rules and regulations establishing reasonable limits on the number of cable subscribers a person is authorized to reach through cable systems owned by such person, or in which such person has an attributable interest [and] to prescribe rules and regulations establishing reasonable limits on the number of channels on a cable system that can be occupied by a video programmer in which a cable operator has an attributable interest . . . ").

framework was to foster a diverse, robust, and competitive market in the acquisition and delivery of multichannel video programming.[8]

5. Congress intended the structural ownership limits of Section 613(f) to ensure that cable operators did not use their dominant position in the multichannel video programming distribution ("MVPD") market,[9] to impede unfairly the flow of video programming to consumers.[10] At the same time, Congress recognized that multiple system ownership could provide benefits to consumers by allowing efficiencies in the administration, distribution, and procurement of programming, and by providing capital and a ready subscriber base to promote the introduction of new programming services.[11]

6. The Commission first established a horizontal ownership limit in 1993, finding that a 30 percent limit would prevent the largest multiple system operators ("MSOs") from gaining enhanced leverage from increased horizontal concentration, while also ensuring that they could take advantage of economies of scale to encourage investment in new video programming services and deploy advanced services.[12] The Commission stated that a 30 percent horizontal ownership limit should protect against any single cable operator exerting undue power that could prevent the success of new video programming

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[8] *See* S. REP. NO. 102-9 (1991) ("*Senate Report*"); *House Report* at 27; *see also* 1992 Act § 2(a)(4), (b)(1)-(5); 47 U.S.C. § 521 (a)(4), (b)(1)-(5).

[9] Multichannel video programming distributors ("MVPDs") include, but are not limited to, providers of cable service, multichannel multipoint distribution service ("MMDS"), direct broadcast satellite service ("DBS"), and television receive-only program distribution services that make "available for purchase by subscribers or customers, multiple channels of video programming." 47 U.S.C. § 522(13).

[10] Communications Act § 613(f)(2)(A), 47 U.S.C. § 533(f)(2)(A). Congress directed that "[i]n prescribing rules and regulations . . . the Commission shall, among other public interest objectives . . . ensure that no cable operator or group of cable operators can unfairly impede, either because of the size of any individual operator or because of joint actions by a group of operators of sufficient size, the flow of video programming from the video programmer to the consumer . . . ensure that cable operators affiliated with video programmers do not favor such programmers in determining carriage on their cable systems or do not unreasonably restrict the flow of the video programming of such programmers to other video distributor . . . take particular account of the market structure, ownership patterns, and other relationships of the cable television industry, including the nature and market power of the local franchise, the joint ownership of cable systems and video programmers, and the various types of non-equity controlling interests . . . account for any efficiencies and other benefits that might be gained through increased ownership or control . . . make such rules and regulations reflect the dynamic nature of the communications marketplace . . . not impose limitations which would bar cable operators from serving previously unserved rural areas; and . . . not impose limitations which would impair the development of diverse and high quality video programming." Communications Act § 613(f)(2)(A)-(G), 47 U.S.C. § 533(f)(2)(A)-(G).

[11] *House Report* at 41, 43; *see also Senate Report* at 27, 33. In prescribing its rules and regulations, the Commission must "account for any efficiencies and other benefits that might be gained through increased ownership or control." 47 U.S.C. § 533(f)(2)(D).

[12] *Implementation of Sections 11 and 13 of the Cable Television Consumer Protection and Competition Act of 1992, Horizontal and Vertical Ownership Limits, Cross-Ownership Limitations, and Anti-trafficking Provisions*, 8 FCC Rcd 8565, 8567, 8577 ¶¶ 3, 25 (1993) (*1993 Second Report and Order*) (prohibiting cable operators from owning systems serving more than 30 percent of all homes passed by a cable operator); *see also id.* at 8569, 8582-84 ¶¶ 8, 37-42 (concluding that the 30 percent limit represented a careful balance between (1) limiting the possible exertion by a cable operator of excessive market power in the purchase of video programming; and (2) ensuring that cable operators are able to expand and benefit from the economies of size necessary to encourage investment in new video programming technology and the deployment of other advanced technologies). The Commission also stated that it intended to review the horizontal limit every five years in order to determine whether it was still reasonable under new market conditions and continued to meet the stated policy objectives. *Id.* at 8583 ¶ 40.

services or "unfairly impede the flow of video programming to the consumer."[13]

7. To better reflect changed market conditions and allow for internal growth in subscribership, in the *1999 Cable Ownership Order*, the Commission revised the 30 percent horizontal limit to permit a cable operator to serve 30 percent of all MVPD subscribers rather than 30 percent of all cable homes passed, as had been the case when the limit was first adopted.[14] As the Commission observed, including all MVPD subscribers rather than merely cable subscribers was equivalent to establishing a 36.7 percent cable subscriber limit.[15] It stated that the change was needed to reflect the growing impact of emerging non-cable MVPDs on the programming marketplace.[16] The Commission characterized its action as a "significant relaxation of the rule," which retained the "theoretical underpinnings" of its original 30 percent limit while taking account of marketplace changes by revising the relevant market definition to include all MVPD subscribers.[17]

8. The Commission reasoned that cable operators at certain concentration levels, "either by unilateral, independent decisions or by tacit collusion," could effectively prevent programming networks from entering or surviving in the marketplace simply by deciding not to carry a particular network, thereby impeding the flow of programming to the consumer.[18] Analyzing industry data, the Commission estimated that a new cable programming network would need access to 40 percent of the MVPD subscribers nationwide to be viable. A 30 percent limit, the Commission reasoned, would allow new programming networks access to a 40 percent "open field" by preventing the two largest cable operators from garnering more than 60 percent of the market.[19] In this regard, the Commission explained, "even if two operators, covering 60 percent of the market, individually or collusively deny carriage to a programming network, the network would still have access to 40 percent of the market, giving it a reasonable chance of financial viability."[20]

9. Cable operators filed a facial challenge to Section 613(f), contending that it violated the First Amendment, but the court in *Time Warner Entertainment Co. v. FCC* ("*Time Warner I*") rejected that argument.[21] With respect to the horizontal ownership limit, the court observed that Congress had identified two important governmental interests at stake: (1) ensuring that dominant cable operators do not "preclude new programming services from attaining the critical mass audience necessary to

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[13] *1993 Second Report & Order*, 8 FCC Rcd at 8577 ¶ 26 (citing 47 U.S.C. § 533(f)(2)(A)).

[14] *Implementation of Section 11(c) of the Cable Television Consumer Protection and Competition Act of 1992 Horizontal Ownership Limits,* 14 FCC Rcd 19098, 19101 (1999) (*1999 Cable Ownership Order*) *see also Implementation of 11(c) of the Cable Television Consumer Protection and Competition Act of 1992 Horizontal Ownership Limits,* 13 FCC Rcd 14462, 14464-65 ¶ 4 (1998) ("*1998 Horizontal Reconsideration Order*") (seeking comment on possible revisions to the horizontal ownership rules and the method by which horizontal ownership is calculated).

[15] *Id.*

[16] *1999 Cable Ownership Order*, 16 FCC Rcd at 19031.

[17] *Id.*

[18] *Id.* at 19114-16 ¶¶ 38-44.

[19] The 40 percent "open field" was based on the Commission's findings that in order to be viable, a new programming network needs access to approximately 15-20 million subscribers (20 percent of the market), and that, even with such access, it has only a 50 percent chance of actually reaching subscribers given tier packaging and consumer preferences. *See 1999 Cable Ownership Order*, 14 FCC Rcd at 19114-18 ¶¶ 40-50.

[20] *Id.* at 19119 ¶ 53.

[21] *Time Warner Entertainment Co. v. United States*, 211 F.3d 1313 (D.C. Cir. 2000) ("*Time Warner I*").

survive";[22] and (2) preserving "diversity of information available to the public."[23] The court upheld the constitutionality of Section 613(f)(1)(A), finding that cable operators had "not demonstrated that the subscriber limits provision is on its face either unnecessary or unnecessarily burdensome."[24]

10. Cable operators subsequently challenged the Commission's specific horizontal limit. In *Time Warner II*, the court did not vacate the 30 percent horizontal limit, but found that the record did not adequately support that limit, and reversed and remanded to the Commission.[25] Addressing the Commission's open field approach, the court found that the Commission lacked evidence that cable operators would collude and that the Commission could not simply assume that cable operators would coordinate their behavior in an anticompetitive manner.[26] The court held that Section 613(f)(1) authorizes the Commission to set a limit to ensure "that no single company could be in a position singlehandedly to deal a programmer a death blow,"[27] but does not authorize the agency to regulate the "legitimate, independent editorial choices of multiple MSOs."[28] Without evidence that two operators might engage in joint anticompetitive conduct, the court concluded that the record would support a limit of 60 percent using the 40 percent open field premise.[29] The court cautioned that, in fashioning another limit, the Commission must recognize that market power depends not only on market share but also on the "*availability* of competition."[30]

11. The court suggested several ways that cable operators could unfairly impede the flow of programming, which might form the basis of a sustainable horizontal limit.[31] The court explained that the Commission might justify a limit by establishing that a single large cable operator acting alone could act anticompetitively by "extort[ing] equity from programmers or forc[ing] exclusive contracts . . . while serving somewhat less than [the market share] . . . that would allow it unilaterally to lock out a new cable programmer."[32] It found, however, that the Commission had failed to offer any evidence or theory of anticompetitive harm arising from the actions of a single cable operator.[33] Finally, the court criticized the Commission's finding that "[w]ith more MSOs making purchasing decisions, this increases the

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[22] *Id.* at 1319.

[23] *Id.* at 1320.

[24] *Id.*

[25] *Time Warner II*, 240 F.3d at 1126. The court also reversed the Commission's 40 percent channel occupancy limit.

[26] *Id.* at 1130.

[27] *Id.* at 1131.

[28] *Id.* at 1135.

[29] *Id.* at 1132-33. The court found it unnecessary to reach the issue of whether the record supported the Commission's premise that new programmers would need access to an "open field" of 40 percent of U.S. subscribers. *Id.* at 1132.

[30] *Id.* at 1134 (emphasis in original).

[31] *Id.* at 1133.

[32] *Id.* We note that, in 1992, Congress instructed the Commission to adopt rules prohibiting cable operators from demanding equity in exchange for carriage. *See* 47 U.S.C § 536; 47 C.F.R. § 76.1301. Despite these protections, the court in *Time Warner II* recognized that "a single MSO, acting alone rather than 'jointly,' might perhaps be able to do so while serving somewhat less than the 60 percent of the market (*i.e.*, less than the fraction that would allow it unilaterally to lock out a new cable programmer) despite the existence of antitrust laws and specific behavioral prohibitions enacted as part of the 1992 Cable Act, *see* 47 U.S.C. § 536, and the risk might justify a prophylactic limit [horizontal cap] under the statute." *Time Warner II*, 240 F.3d at 1133.

[33] *Id.* at 1132-34.

likelihood that the MSOs will make different programming choices and a greater variety of media voices therefore will be available to the public," holding that that the Commission may not, on the basis of the diversity goal alone, adopt a limit that does more than ensure the availability of at least two conduits through which programmers may serve an adequate number of consumers.[34] The court found that a cable operator's size would constitute an unfair impediment to the flow of programming if that operator were the only viable conduit for programming "independent of concerns over anticompetitive conduct."[35]

12. In response to *Time Warner II*, the Commission sought comment on the status of the MVPD industry and various proposals for a new horizontal limit.[36] The Commission specifically sought information concerning the contractual relationships between programmers and cable operators in order to establish the extent of cable operators' market power and the effects of market power on the quantity and quality of programming, as well as the effects of market power on the programming costs of smaller MVPDs.[37] Commenters presented numerous arguments in response to the *2001 Further Notice*, but the record did not contain sufficient evidence to allow the Commission to set reasonable and sustainable horizontal and vertical ownership limits.[38]

13. In 2002, the Commission sought to obtain empirical data and information by conducting a programming network survey[39] and an experimental economics analysis,[40] and it sought comment on theoretical analyses designed to determine the relationship between bargaining power and buyer size in a bilateral bargaining environment.[41] The experimental economics analysis ("BKS Study") was designed to determine whether changes in MVPD concentration might impede the flow of programming to consumers by creating potentially problematic bargaining outcomes. The BKS Study created an experimental market that included many of the features of the actual market in which MVPDs and cable programming networks negotiate affiliate fees (*e.g.*, trades involving differentiated products, differences in the level of non-avoidable sunk costs incurred by buyers and sellers, and the use of a sequential bilateral bargaining process to negotiate fees). The study found that increasing concentration could impede the flow of programming, according to some measures of market performance. However, the BKS Study did not model some potentially important aspects of the industry (*i.e.*, vertical integration,

[34] *Id.* at 1131-32, 1134.

[35] *Id.* at 1131-32.

[36] *Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992,* Further Notice of Proposed Rulemaking, 16 FCC Rcd 17312 17320-21 ¶ 7 (2001) (*"2001 Further Notice").*

[37] *Id.* at 17316-34 ¶¶ 2-45; 17338-47 ¶¶ 50-73; 17349-52 ¶¶ 76-84.

[38] *See The Commission's Cable Horizontal and Vertical Ownership Limits*, Second Further Notice of Proposed Rulemaking, 20 FCC Rcd 9374, 9385 ¶ 17 (2005) ("*2005 Second Further Notice*").

[39] *See* Letter from W. Kenneth Ferree, Chief, Cable Services Bureau, FCC, to Programming Network Owners (Feb. 15, 2002). The letter sought information from programming network owners for each network in which they had an interest, including the number of subscribers at the time the network became profitable, the number of subscribers at the end of calendar years 1997-2001, and information on the vertical integration status and genre of each network.

[40] Mark Bykowsky, Anthony Kwasnica, & William Sharkey, *Horizontal Concentration in the Cable Television Industry: An Experimental Analysis*, FCC Office of Plans and Policy, Working Paper No. 35 (June 2002 & rev. July 2002) ("*BKS Study*"). The BKS Study was released for public comment and generated a substantial record in response.

[41] Public Notice, Media Bureau Releases Two Staff Research Papers Relevant to the Cable Ownership Rulemaking and the AT&T-Comcast Proceedings, 17 FCC Rcd 19608 (MB 2002) (citing Nodir Adilov & Peter J. Alexander, *Asymmetric Bargaining Power and Pivotal Buyers*, FCC Media Bureau Working Paper No. 13 (Sept. 2002) ("*Asymmetric Bargaining Power*"); Nodir Adilov & Peter J. Alexander, *Most-Favored Customers in the Cable Industry*, FCC Media Bureau Working Paper No. 14 (Sept. 2002)).

retail competition from DBS, entry into and exit from the cable network programming industry.) Similarly, the theoretical work released by the Commission suggested that, under certain conditions, increased firm size can produce an improved bargaining position and adversely affect the flow of programming.[42] While these analyses of bargaining power show that increasing horizontal size imparts increased bargaining power to the largest buyer of video programming, they did not indicate the point at which such increased bargaining power is likely to impede the flow of programming to consumers.

14. In 2005, the Commission again sought comment to update and supplement the record.[43] The Commission observed that three significant events had changed the structure of the media industry since the close of the record on the *2001 Further Notice*: (1) the 2002 Comcast-AT&T cable transaction had resulted in one entity having a share of MVPD subscribers very close to the remanded 30 percent ownership limit;[44] (2) the 2003 News Corp.-Hughes transaction had created the first vertically integrated DBS operator, involving a number of video programming assets;[45] and (3) courts had remanded several media ownership rules, requiring that the Commission more firmly base its rules on empirical data and record evidence.[46] The Commission sought comment on the proposals in the record, recent developments in the industry, and certain tentative conclusions. It asked commenters to supplement the record where possible by providing new evidence and information to support the formulation of horizontal and vertical limits, and invited parties to undertake their own studies in order to further inform the record.[47] The Commission also sought comment on three analytical frameworks for determining whether, and at what level, a cable operator's size is likely to impede the flow of programming to consumers or diminish effective competition: (1) the open field approach, (2) an approach based on monopsony theory,[48] and (3) an approach based on bargaining power as a source of unilateral anticompetitive action. Finally, the Commission invited comment on Media Bureau Staff Research Paper No. 2004-1,[49] which examined the

[42] *See generally Asymmetric Bargaining Power, supra* note 41, at 1-2, 8.

[43] *2005 Second Further Notice, supra* note 38.

[44] *See Applications for Consent to the Transfer of Control of Licenses, Comcast Corporation and AT&T Corp., Transferors, to AT&T Comcast Corporation, Transferee*, 17 FCC Rcd 23246 (2002) (*AT&T-Comcast Order*).

[45] *General Motors Corporation and Hughes Electronics Corporation, Transferors, and the News Corporation Limited, Transferee*, Memorandum Opinion and Order, 19 FCC Rcd 473 (rel. Jan. 14, 2004) ("*News Corp-Hughes Order*"). The programming assets involved in the transaction included 35 owned and operated (O&O) full-power television broadcast stations, a national television broadcast network, ten national cable programming networks, and 22 regional cable programming networks.

[46] *Fox Television Stations, Inc. v. FCC*, 280 F.3d 1027 (D.C. Cir. 2002), *modified on rehearing*, 293 F.3d 537 (D.C. Cir. 2002) (remanding the Commission's retention of the then congressionally-established 35 percent national television ownership rule); *Sinclair Broadcasting Group, Inc. v. FCC*, 284 F.3d 148 (D.C. Cir. 2002) (*Sinclair*) (remanding the Commission's 1999 revision of its local television multiple ownership rule); *Prometheus Radio Project, et al. v. FCC*, 373 F.3d 372 (3rd Cir. 2004), *stay modified on rehearing*, No. 03-3388 (3rd Cir. Sept. 3, 2004), *cert. denied*, 545 U.S. 1123 (U.S. June 13, 2005) (Nos. 04-1020, 04-1033, 04-1036, 04-1045, 04-1168, and 04-1177) (remanding the cross-media limits, the local television multiple ownership rule, and the local radio ownership rule).

[47] *2005 Second Further Notice*, 20 FCC Rcd at 9385 ¶ 16.

[48] In a monopsony market, a large buyer has the market power to drive down prices. A monopsony market is sometimes referred to as a buyer's monopoly.

[49] Keith S. Brown, *A Survival Analysis of Cable Networks*, Media Bureau Staff Research Paper No. 2004-1 (rel. Dec. 7, 2004) ("*Media Bureau Survival Study*"). The *Media Bureau Survival Study* uses the statistical tools of survival or duration analysis to estimate how different variables affect a cable network's probability of survival and expected length of life. Using these results, the study estimates the number of subscribers a cable network needs for any given probability of survival over a given length of time. The *Media Bureau Survival Study* concludes, for example, that a network growing at an average rate requires approximately 42 million subscribers to have a 70 percent probability of (continued....)

effect of subscribership on a network's ability to survive in the marketplace.[50]

15. In response to the *2005 Second Further Notice*, commenters submitted new evidence and in some cases specific proposals. Parties advocating adoption of a limit at or below 30 percent submitted comments and economic analysis concerning the theories set forth in the *Notice* and proffered evidence related to programmer viability, the importance of distribution in top markets, the role of DBS in the programming and distribution markets, and the carriage decisions of the two largest multiple-system cable operators, Comcast and Time Warner.[51] These commenters advocate use of either an open field approach (CFA, CWA) or a monopsony analysis (MAP), with some urging discounting the market shares held by DBS (CFA) and consideration of the harmful effects of regional concentration and clustering (CFA, CWA, DirecTV, NAB).[52] In addition, the record includes three academic studies concerning the impact of ownership structure on the market for programming.[53] These papers argue that the largest cable operators already exercise monopsony power and engage in vertical foreclosure of rival networks and tacit collusion through reciprocal carriage of vertically integrated networks. In contrast, cable industry commenters (Comcast, Time Warner, NCTA, and the American Cable Association) and the Progress and Freedom Foundation ("PFF") support elimination of the cap.[54] They argue that the methodologies proposed for establishing a cap are flawed, that competition in the MVPD and video programming market prevents them from engaging in anticompetitive behavior, and that cable operators lack the incentive to collude.[55] Cable operators also argue that consumers will benefit from their larger size, due to the efficiencies gained from increased size and from a reduction in cable operators' costs resulting from the lower prices for programming purchased.[56] They claim that larger cable operators will tend to invest in cable systems with greater capacity, and therefore a national ownership cap could stymie the deployment of large-capacity systems and thereby increase the likelihood that video networks would fail to obtain widespread carriage.[57]

16. Below we review the record pertaining to each of the theories addressed in the *2005 Second Further Notice* and discuss the basis for our findings. We conclude that a modified open field approach

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survival over its first 10 years. The study was placed in the record of this proceeding concurrently with the release of the *2005 Second Further Notice*.

[50] *2005 Second Further Notice*, 20 FCC Rcd at 9385 ¶ 16.

[51] *See, e.g.*, TAC Comments to the *2005 Second Further Notice* at 13-23 (addressing carriage decisions of Comcast and Time Warner, programmer viability, and top-market distribution); CFA Comments to the *2005 Second Further Notice* at 69 (addressing the role of DBS in markets); Comcast Reply Comments to the *2005 Second Further Notice*, Ordover and Higgins Decl. at 8-9 (discussing impact of DBS on programming pricing).

[52] CFA Comments to the *2005 Second Further Notice* at 25-26, 69-70; CWA Comments to the *2005 Second Further Notice* 12-13; MAP Comments to the *2005 Second Further Notice* at 6-10, 29-35; DirecTV Comments to the *2005 Second Further Notice* at 5-9; NAB Reply Comments to the *2005 Second Further Notice* at 2-5.

[53] *See* Comments of Dong Chen, Jun-Seok Kong and David Waterman to the *2005 Second Further Notice*.

[54] *See* Comcast Reply Comments to the *2005 Second Further Notice* at 26; Time Warner Reply Comments to the *2005 Second Further Notice* at 9; NCTA Comments to the *2005 Second Further Notice* at 16-17; ACA Comments to the *2005 Second Further Notice* at 8 (suggesting elimination of the horizontal limit in smaller markets); PFF Comments to the*2005 Second Further Notice* at 46.

[55] *See, e.g.*, Comcast Comments to the *2005 Second Further Notice* at 13, 16, 60-69, 74-79. Comcast also claims that, absent record evidence of actual harms that the cap is designed to address, any horizontal ownership limit would be unduly burdensome and overly broad. Accordingly, it claims that a cap would violate the First Amendment under the intermediate scrutiny test applicable to cable ownership regulations. Comcast Supp. Comments at 23-24.

[56] *See, e.g., Id.* at 16, 74.

[57] Comcast March 16, 2007 Further Supp. Comments, Erdem, Katz, and Morgan Decl. at 34-35.

will best identify the point at which a cable operator's size is likely to unfairly impede the flow of programming to consumers.

B. Analytical Framework

1. Background

17. As noted above, the Commission has sought comment on three possible approaches to use in fashioning a horizontal ownership limit: (1) the open field approach, which examines whether one or more cable operators are large enough to effectively limit the viability of a programming network if they denied it carriage; (2) monopsony theory, which considers whether a cable operator has sufficient market power to restrict the price it pays for programming by purchasing less of it and thereby restrict the flow of programming to subscribers; and (3) bargaining theory, which examines the negotiations between the programming network and the cable operator in order to determine the point at which programmers will curtail their activities and thereby limit the quality and diversity of programming.[58] We discuss each of those approaches here and determine that the open field approach, suitably modified, represents the best method of determining an appropriate horizontal limit. We determine that monopsony theory does not apply to this market because of the lack of a single market price in the market for programming. Although we find that bargaining theory is useful in establishing the need for a limit, the record is insufficient to derive a specific limit using this theory.

a. The Open Field Approach

18. The open field approach determines whether a programming network would have access to alternative MVPDs of sufficient size to allow it to successfully enter the market, if it were denied carriage by one or more of the largest cable operators. The Commission adopted this approach in 1999 to set a 30 percent horizontal limit based on a theory that cable operators at certain concentration levels could effectively prevent programming networks from entering or surviving in the marketplace simply by deciding not to carry them.[59] The Commission found that a new programming network needs access to 15 to 20 million subscribers to be viable and that the typical programming network had only a 50 percent chance of actually serving all available MVPD subscribers.[60] The Commission concluded that a programmer needed to have an "open field" of 40 percent of MVPD subscribers nationwide and that a 30 percent MVPD subscriber limit would assure that a 40 percent open field remained even if the two largest cable operators decided not to carry it.[61] The Commission determined that calculations of the horizontal limit should include all MVPD subscribers, including non-cable MVPD subscribers, to take into account the increased market share of non-cable MVPDs.[62]

19. Several commenters support using an open field approach, and argue that it would produce a horizontal ownership limit of 30 percent or lower. CWA calculates that the appropriate limit is 27 percent of MVPD subscribers, based on an open field approach.[63] CFA states that the necessity of a horizontal limit of 20-30 percent is demonstrated by the open field approach.[64] In support of the open

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[58] *2001 Further Notice*, 16 FCC Rcd at 17338-47 §§ 52-74; *2005 Second Further Notice*, 20 FCC Rcd at 9417-26 ¶¶ 80-100. The Commission also sought comment on an appropriate channel occupancy limit. That issue is addressed below in the *Further Notice*, *see infra* Section III.

[59] *1999 Cable Ownership Order*, 14 FCC Rcd at 19117 ¶ 47.

[60] *Id.* at 19115-16 ¶¶ 42-43.

[61] *Id.* at 19119 ¶ 53.

[62] *Id.* at 19121 ¶ 57.

[63] CWA Comments to the *2005 Second Further Notice* at 12-13.

[64] CFA Comments to the *2005 Second Further Notice* at 69-70.

field approach, The America Channel provides an extensive discussion of the number of subscribers a programming network requires in order to remain viable, as well as information on the impact of large cable operators' programming decisions on the programming market.[65]

20. In contrast, other commenters claim that an open field approach cannot justify any horizontal limit.[66] For example, some commenters criticize the Commission's determination that a new network needs 15 million subscribers to survive in the marketplace, contending that many successful programming networks serve fewer than 15 million subscribers.[67] MAP urges the Commission to jettison the open field approach and use monopsony theory instead, claiming that Congress intended the ownership limit to address market power generally rather than create an open field for programmers.[68] NCTA asserts that the open field approach is too difficult to apply empirically because, it argues, gathering the average number of subscribers needed by programming networks with any precision would be very difficult.[69] Comcast contends that "no open field-based limit could be sustained because it is based on a series of arbitrary and unsupportable assumptions[,]"[70] a static market analysis, collusion theory, and a 40-60 million subscriber threshold for viability.[71]

b. Monopsony Framework

21. Monopsony theory examines whether a buyer has sufficient market power to force down the price it pays for a homogenous input by reducing its purchases, and whether this is inefficient, in a market with a single price for all units of the input purchased.[72] A firm acting as a buyer of an input is said to have monopsony power when it has the ability to establish the price at which input is purchased.[73] In the *Further Notices*, the Commission sought comment on the harms to the supply of programming that might result from the exercise of market power in a highly concentrated MVPD market.[74] The Commission asked at what level of concentration a large cable operator gains sufficient market power to be able to refuse carriage of programming for reasons other than consumer demand.[75] In 2005, the

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[65] TAC Comments to the *2005 Second Further Notice* at 13-23.

[66] *See* AT&T Comments to the *2001 Further Notice* at 61-68, Besen Decl. at ¶¶ 3, 11, 14, Ordover Decl. at ¶¶ 142-45; Time Warner Comments to the *2001 Further Notice* at 19-28; Time Warner Reply Comments to the *2001 Further Notice* at 14-18.

[67] AT&T Comments to the *2001 Further Notice* at 63-66, Besen Decl. at ¶¶ 3-6; Time Warner Comments to the *2001 Further Notice* at 24-26; Time Warner Reply Comments to the *2001 Further Notice* at 17-18.

[68] MAP Comments to the *2005 Second Further Notice* at 6-10.

[69] NCTA Comments to the *2005 Second Further Notice* at 14.

[70] Comcast Comments to the *2005 Second Further Notice* at 75.

[71] *Id.* at 74-79. Comcast apparently derives its 40-60 million subscriber threshold from a single statement in the *2005 Second Further Notice* describing CFA as believing that a "far greater open field may be necessary for competitive entry by a new programmer, as much as 30 to 40 million subscribers instead of the 15 million figure previously relied on by the Commission." *Id.* at 75 n.226 (citing *2005 Second Further Notice*, 20 FCC Rcd at 9417 ¶ 79). Comcast also argues that the purpose of Section 613(f)(1)(A) of the Act is to avoid anticompetitive behavior in the "wholesale" video programming market, and, thus, the Commission's focus on the economic success or failure of any particular video programmer in the marketplace is misplaced. Comcast April 4, 2007 *ex parte* letter at 2-3.

[72] *See*, e.g., Dennis Carlton & Jeffrey Perloff, MOD. INDUS. ORG. 105-07 (3d ed. 2000) ("Carlton and Perloff").

[73] In contrast, under perfect competition, no single buyer has the ability to affect the price at which an input is acquired.

[74] *2001 Further Notice*, 16 FCC Rcd at 17340 ¶ 57; *2005 Second Further Notice*, 20 FCC Rcd at 9420-23 ¶¶ 85, 87-88.

[75] *2001 Further Notice*, 16 FCC Rcd at 17328, 17340-41 ¶¶ 28, 58.

Commission generally sought comment on the appropriateness of applying standard monopsony arguments in this context,[76] and asked how monopsony power can be measured and whether certain observed industry practices and actions-- such as launch fees[77] and requests for equity in the programming network by the cable operator-- are indications that monopsony power is being exercised.[78] The Commission observed that the most significant challenge to the use of a monopsony model is the apparent requirement that there be a public market price that would be affected by a monopsonist's purchasing decisions.[79] Because the market for programming appears to be characterized by private bilateral negotiations yielding complex prices that are not made public, the Commission asked whether this means there is no market price that could be used in an application of the monopsony model.[80]

22. CFA and MAP claim that cable operators' large size enables them to exercise monopsony power in the purchase of programming. Citing to numerous economic and legal texts, CFA and MAP maintain that the theory of monopsony power is well-developed as the "flip-side" of the theory of monopoly power.[81] They assert that the theory of monopsony applies to the market for programming,[82] contending that a large cable operator will have the ability and incentive to hold down the price for programming, which will reduce the quantity of programming supplied.[83]

23. A published paper submitted by David Waterman provides an alternative model to the usual monopsony model to show how the exercise of monopsony power in the market for programming can reduce the flow of programming.[84] In Waterman's model, upstream suppliers have economies of scale in producing and distributing a differentiated input to downstream retail firms. Waterman states that this model is similar to the supply of cable network programming to cable companies. The downstream firms have an incentive to force the price down to the marginal cost of distribution and rely on other buyers to cover the fixed costs of producing the programming. According to Waterman, the ability of a buyer to "free ride" in such a manner depends on its bargaining power, which, in turn, depends on its size in the national marketplace. Based on his model, Waterman finds that, as the buyer grows in size in the national marketplace, its *incentive* to offer a lower price for programming declines somewhat (because there are fewer other buyers on which to free ride), but its *ability* to force the price down increases substantially.[85] The result of this effect, however, may be to reduce the revenues available to upstream suppliers, to the point that not all of the networks will be able to cover their fixed costs. The number of networks would then decline, reducing the product variety supplied to the downstream firms. Waterman notes that the negative externality on industry profits created by opportunistic input price setting can be internalized, either by vertical integration, or by industry-wide cooperative behavior (creating a large monopsony that controls the entire market).[86] In these two cases

[76] *2005 Second Further Notice,* 20 FCC Rcd at 9421 ¶ 87.

[77] In the case of a new programming network, an MVPD may demand that the programmer pay it for the right to access its subscribers (a practice sometimes referred to as a "launch fee"). *Id.* at 9421 n. 32.

[78] *Id.* at 9421-22 ¶ 88.

[79] *Id.* at 9422 ¶ 89.

[80] *Id.*

[81] CFA Comments to the *2005 Second Further Notice* at 62-67; MAP Comments to *2001 Further Notice* at 85-90.

[82] CFA Comments to the 2005 *Second Further Notice* at 67-68; MAP Comments to *2001 Further Notice* at 90-91.

[83] CFA Comments to *2005 Second Further Notice* at 61-62; MAP Comments to *2001 Further Notice* at 91.

[84] Comments of Dong Chen, Jun-Seok Kang and David Waterman to the *2005 Second Further Notice* (citing David Waterman, *Local Monopsony & Free Riders*, 8 INFO. ECON. & POLICY 337, 337-355 (1996) ("*Waterman Study*").

[85] *Waterman Study* at 339-41, 350-51.

[86] *Id.* at 350-51.

the buyer has an incentive to provide a price high enough to cover the fixed costs of networks, and will not attempt to free ride on other buyers' covering programming networks' fixed costs.

24. NCTA contends that there is no monopsony in the cable industry because every household has a choice of at least three MVPDs.[87] Comcast asserts that the monopsony model does not apply, because the supply of video programming must be characterized as a flat line rather than an upward--sloping supply curve. According to Comcast, the seller's marginal cost of supply is effectively zero, once first copy costs have been incurred.[88] Comcast notes that programming is purchased through individualized negotiation, and rather than walking away from a high price, it would continue negotiating until the parties agree on price.[89] Comcast also contends that it is impossible to compare the prices paid for programming, because prices are complex and differ for each transaction for a variety of reasons.[90] Finally, Comcast contends that if larger size allowed the cable operator to negotiate lower prices for programming, it would lower the cable operator's costs and consumers would reap the benefit.[91]

25. AT&T maintains that a cable monopsonist can only exist in a hypothetical world because real world video programming suppliers have many non-cable distribution alternatives.[92] AT&T adds that even if a cable monopsonist had the ability to insist on a price so low that a programmer would be forced either to exit the market or reduce its quality, the monopsonist would have no incentive to do so. AT&T states that an MSO's need for program quantity and quality is determined by consumer demand and retail competition, factors that it says are independent of the acquisition of monopsony power over programmers.[93] AT&T concludes that, regardless of its market power, MSOs seek programming that will draw the greatest number of viewers relative to the cost of the programming, and acquisition of monopsony power does not reduce the retail competitive pressures MSOs face.[94] AT&T submits that what remains is simply a private negotiation over how the two contracting parties will split the joint surplus that is created when the programmer agrees to sell programming to the MSO.[95]

c. Bargaining Theory

26. A branch of game theory, bargaining theory examines the determinants of a bargaining outcome, where outcome is defined in terms of whether a bargain is struck and, if struck, the share of the

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[87] NCTA Comments to the *2005 Second Further Notice* at 7-8 (NCTA states that consumers have access to at least one cable operator and two DBS operators).

[88] Comcast Comments to the *2005 Second Further Notice* at 69-70; Comcast Supp. Comments at 15-16; Comcast March 16, 2007 Further Supp. Comments at 6. Joskow and McLaughlin maintain that cable operators do not have "textbook" monopsony power, because they lack "the critical element necessary to give firms monopsony power in input markets . . . that the buying firms individually face upward-sloping input (i.e., labor) supply curves and recognize that by buying fewer inputs they can reduce the *market price* that they pay for these inputs." Time Warner Comments to *the 2001 Further Notice*, Joskow & McLaughlin Decl. at 8-10 (emphasis in original).

[89] Comcast Comments to the *2005 Second Further Notice* at 71-72.

[90] *Id.* at 70. Comcast March 16, 2007 Further Supp. Comments at 6.

[91] Comcast Comments to the *2005 Second Further Notice* at 67, 74.

[92] AT&T Comments to the *2001 Further Notice* at 44, Ordover Decl. at ¶ 72. *See also* Comcast Supp. Comments at 16.

[93] AT&T Comments to *2001 Further Notice* at 44, Ordover Decl. at ¶ 74.

[94] AT&T Comments to *2001 Further Notice* at 44-45.

[95] AT&T Comments to *2001 Further Notice* at 45, Ordover Decl. at ¶¶ 72-76.

gains that accrue to each side of the bargain.[96] In 2001, the Commission suggested that excessive bargaining power could enable cable operators to force down the prices they pay to programmers, causing the programmers to curtail their activities and thereby limit the quality and diversity of programming.[97] In 2005, the Commission sought comment on the use of bargaining theory to establish a horizontal ownership limit.[98] Noting that bargaining theory is often used to model bilateral negotiations, the Commission suggested that, as compared to monopsony theory, bargaining theory may better describe and model the private negotiations and non-public terms of agreements typically employed in the purchase of programming by cable operators.[99] The Commission considered several possible sources of inefficiency that can occur when one side has significant bargaining power.[100] One potential source of inefficiency is the lower prices paid for programming where the supply of programming is competitive.[101] The low prices resulting from an excessive amount of bargaining power can prevent suppliers from recovering their fixed costs, causing them to exit the market or avoid entering with new programming. Another source of inefficiency is the "hold-up problem," in which suppliers underinvest in programming out of fear that if they commit themselves to making a substantial upfront investment in programming they will have a weaker bargaining position and will later be forced to accept lower prices.[102] The third source of inefficiency occurs when mutually beneficial trades fail to occur because the parties are uncertain about the size of the surplus available from a completed deal, and accordingly ask for too much.[103] The Commission asked whether an increasing level of concentration among cable operators is likely to reduce the bargaining power of programmers to such an extent that (1) programmers cannot recover their costs, (2) the hold-up problem is amplified, or (3) the likelihood of bargaining breakdown increases.[104] The Commission sought comment on which of these economic inefficiencies may rise to the level of reducing the flow of programming to consumers.

27. Comcast argues, based on a study it provides, that there is no evidence that increased concentration is likely to result in any of the proposed scenarios.[105] Instead, Comcast claims that if concentration has any effect at all, it is more likely to increase the ability of programmers to cover their costs, thereby encouraging the production of programming.[106] Cable industry commenters rely on the work of Alexander Raskovich[107] to support their position that large firm size could, in fact, weaken a cable operator's bargaining position. For example, AT&T suggests that increased firm size reduces the

[96] *See*, e.g., JURGEN EICHBERGER, GAME THEORY FOR ECONOMISTS Ch. 9 (Academic Press, Inc. 1993); ERIC RASMUSEN, GAMES AND INFORMATION: AN INTRODUCTION TO GAME THEORY Ch. 10 (Blackwell Publishing, Inc. 1989).

[97] *2001 Further Notice*, 16 FCC Rcd at 17327 ¶ 26.

[98] *2005 Second Further Notice*, 20 FCC Rcd at 9423-24 ¶¶ 93, 94-95.

[99] *Id.* at 9422-23 ¶¶ 90-92.

[100] *Id.* at 9423 ¶ 93.

[101] *Id.*

[102] *Id.* at 9424 ¶ 94.

[103] *Id.* at 9424 ¶ 95.

[104] *Id.* at 9424-25 ¶ 96.

[105] Comcast March 16, 2007 Further Supp. Comments at 7-9, Erdem, Katz, and Morgan Decl. at ¶¶ 30-44.

[106] Comcast March 16, 2007 Further Supp. Comments at 6, 7-8, Erdem, Katz, and Morgan Decl. at ¶ 2.

[107] See Raskovich Comments to the *2001 Further Notice*, later revised and published as Alexander Raskovich, *Pivotal Buyers and Bargaining Position*, 51 J. OF INDUS. ECON. 4, 405-26 (Dec. 2003) ("Raskovich, *Pivotal Buyers and Bargaining Position*").

likelihood of hold-up, because a larger cable operator can less credibly threaten to free-ride than a smaller cable operator, because the larger operator stands to lose more if it fails to carry programming that consumers value.[108] Moreover, if a buyer becomes so large that it becomes "pivotal" to a supplier's production decision, the buyer cannot credibly abdicate responsibility for ensuring that the supplier's costs are covered. Time Warner, relying on Raskovich as well as a paper by Chipty and Snyder,[109] claims that the larger cable operators' decreased bargaining power results in larger operators "sharing in efficiencies that they have helped to create rather than exerting greater buyer market power."[110] Comcast also suggests that a cable operator would not exploit its bargaining power over programming for short-term gain because it would negatively affect its reputation and future programming negotiations.[111] NCTA concludes that the complexity of applying bargaining theory makes it difficult to determine the single point at which horizontal ownership would begin to have adverse effects on the programming market.[112]

2. Discussion

28. Open Field Analysis: We find that a modified open field approach best enables us to implement a horizontal ownership limit designed to prevent a single cable operator from unfairly impeding the flow of programming to consumers in such a way as to undermine the statutory objective to enhance effective competition. Our application of this approach will ensure that no single operator can create a barrier to a programming network's entry into the market or cause a programming network to exit the market simply by declining to carry the network. The *Time Warner II* court acknowledged that the exercise of editorial discretion by a single cable operator can unfairly impede the flow of programming if the operator is so large that its decision not to carry the network seals its fate.[113] The open field approach we adopt here results in a limit that ensures that the success of a programming network does not rely entirely on the carriage decision of a single cable operator. This approach prevents harms to the flow of programming caused by a number of possible factors, discussed below.

29. A cable operator may fail to carry a network valued by consumers for several reasons,

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[108] AT&T Comments to the *2001 Further Notice*, Ordover Decl. at ¶¶ 78-81; AT&T Comments to the *2001 Further Notice* at 47; *See also* Comcast March 16, 2007 Further Supp. Comments at 8, Ergam, Katz, and Morgan Decl. at ¶¶ 22-24.

[109] Tasneem Chipty & Christopher Snyder, *The Role of Firm Size in Bilateral Bargaining: A Study of the Cable Television Industry*, 81 REV. ECON. & STAT. 2, 326-40 (1999).

[110] Time Warner Comments to *2001 Further Notice*, Joskow and McLaughlin Decl. at 15. *See also* Comcast March 16, 2007 Further Supp. Comments at 9. Raskovich's model is a generalization of the work of Chipty and Snyder, who construct a bargaining framework in which a program seller engages in simultaneous bilateral bargaining with multiple program buyers. Raskovich amended the model of Chipty and Snyder to include pivotal buyers, that is, buyers without whom sellers would produce zero output. Assuming that there is an even split between buyers and seller (i.e., 50 percent-50 percent of a trade's surplus), Raskovich demonstrated conditions under which the pivotal buyer finds its bargaining position worsened. Raskovich posited a situation in which a buyer becomes so large through merger that only the buyer can cover the seller's cost of producing programming. In this context, the programmer's surplus from bargaining with the single large cable operator would be greater than the sum of the surpluses the programmer would receive from the two buyers prior to the merger. This implies that once a cable operator reaches a sufficient size, its payments to programmers will increase. Raskovich, *Pivotal Buyers and Bargaining Position, supra* note 107 at 3-4; *2005 Second Further Notice*, 20 FCC Rcd at 9425 ¶ 98.

[111] Comcast March 16, 2007 Further Supp. Comments at 8, Erdem, Katz, and Morgan Decl. at ¶ 25.

[112] NCTA Comments to the *2005 Second Further Notice* at 13.

[113] *Time Warner II*, 240 F.3d at 1135 ("The statute goes further, plainly treating exercise of editorial discretion by a single cable operator as 'unfair' simply because that operator is the only game in town.").

including reasons related to market failures.[114] For example, if there is asymmetric information about the costs and value of the network, inefficient trading will result, and negotiations can break down.[115] Thus, a network might not be carried by a cable operator because the parties cannot agree to a price, even though consumers value it and both the programmer and the cable operator would profit from the deal. Second, the cable operator may mistakenly believe that the network will not be popular with consumers. The open field approach ensures that a single operator's mistake in judgment will not prevent a valued network from reaching consumers.

30. Cable operators may also fail to carry programming valued by consumers for reasons unrelated to the dynamics of marketplace competition. For example, a large cable operator may prefer to carry only that programming whose content reflects its viewpoint and tastes. One of the Commission's goals is to maintain diversity of programming in the marketplace.[116] In addition to our competitive analysis, therefore, we have considered how the horizontal limit serves the public interest by promoting diversity of programming in the MVPD market.[117] As the *Time Warner II* court recognized, in promoting this goal, the Commission "is on solid ground in asserting authority to be sure that no single company could be in a position singlehandedly to deal a programmer a death blow."[118] If it can profitably sell its programming to multiple cable operators with different viewpoints and tastes, a network will not be pressured to make changes in the content and viewpoint of its programming to suit the desires of the largest cable operator. Our horizontal limit, and the framework supporting it, ensure that the largest cable operator will not be so large that the operator's failure to carry a network will prevent that network from entering or surviving in the market.

31. We conclude that the traditional models of monopsony and bargaining theories as applied to the available evidence are unable to predict the point at which an increase in cable operator concentration will unduly restrict the flow of programming. We find that the necessary assumptions for a traditional monopsony model do not hold in the programming market and that bargaining theory is

[114] We define a "network valued by consumers" as a network for which consumers' willingness to pay exceeds the cost of the network.

[115] The Myerson-Satterthwaite theorem says that if both parties have incomplete information about both the cost and value of the good, even if trade would likely be beneficial, there exists no efficient bargaining process. Jean Tirole, THE THEORY OF INDUS. ORG. 22-23 (THE MIT PRESS 1988); Roger Myerson and M. Satterthwaite, *Efficient Mechanisms for Bilateral Trading*, 28 J. OF ECON. THEORY 265, 265-81 (1983). Akerlof's famous used car example demonstrates that if there is uncertainty about the value of a product, under certain conditions no deal will be reached even though both parties would benefit from it. This problem is known as adverse selection, in which uncertainty about sellers' quality can cause market quality to decline to the lowest level, or prevent the market from functioning at all. Carlton & Perloff, *supra* note 72 at 423-25 (for example, in a market with high and low quality goods offered, in which only the sellers know the quality of the goods, then only the lowest quality goods will be sold. This is because buyers will only offer a price that reflects the average value of the goods, which the sellers of the high quality goods will reject because it is less than the value of their goods.); George A. Akerlof, *The Market for 'Lemons': Quality Uncertainty and the Market Mechanism,* 84 Q. J. OF ECON. 488-500 (1970).

[116] In setting the horizontal limit adopted herein, we have focused primarily on the competitive dynamics of the multichannel video programming marketplace. Additionally, we have considered how the horizontal limit serves the public interest by promoting diversity of programming in the multichannel video programming market. *See Time Warner II*, 240 F.3d at 1134-36 (instructing that the Commission may set a horizontal limit based in part on diversity of programming outlets when it sets a limit primarily designed to achieve Congress' directive of promoting fair and effective competition).

[117] *See Time Warner II*, 240 F.3d at 1134-36 (instructing that the Commission may set a horizontal limit based in part on diversity of programming outlets when it sets a limit primarily designed to achieve Congress' directive of promoting fair and effective competition).

[118] *Time Warner II*, 240 F.3d at 1131.

inadequate for determining whether specific harms to the programming market are likely to result from an increase in bargaining power by cable operators. Thus while a number of likely harms to the flow of programming can be identified, the traditional economic theories of monopsony power and bargaining are not useful for setting a limit in these circumstances.

32. Monopsony Model: We agree with those commenters who argue that the traditional monopsony model is not useful in analyzing the impact of cable operators' market power on the flow of programming.[119] The usual requirement for a monopsony model to be employed – that the supply of programming for each firm be sensitive to a market price (thus yielding an upward-sloping supply curve) – does not hold here. Under the traditional monopsony model, a monopsonist, because it is the only buyer, has the ability to set the price at which its desired input is acquired. And because of the existence of an upward sloping supply curve, it achieves a lower price by restricting the quantity of that input it acquires. In the market for programming, however, negotiations between programmers and cable operators are bilateral and largely confidential.[120] Thus for every potential purchase that could yield a positive benefit to consumers, the cable operator has an incentive to negotiate a price and purchase the programming.[121] From the perspective of a cable operator, agreeing to a higher price in a particular transaction for programming that has a higher cost may not raise the cost of purchasing programming from other sellers, as would occur in the usual monopsony model. In addition, the negotiated prices are complex and difficult to compare.[122] Thus, there is no market price to be affected, and the usual incentive for a firm to exercise monopsony power does not occur in this market. In any event, even assuming that monopsony theory could be applied to this market, the record before us is inadequate to make a determination of the relevant market price.

33. We agree with Ordover and Higgins's contention that Waterman's model of monopsony, in which a large buyer with market power may attempt to pay only for the distribution costs and not for the fixed costs of producing programming, also does not apply here. As Ordover and Higgins note, the existence of most favored nation clauses ("MFNs") in many programming contracts prevents one MVPD from gaining a lower price than other MVPDs for the same programming. This eliminates cable operators' ability to free ride on other MVPDs' paying for the fixed costs of creating the programming.[123] In addition, Waterman assumes that MVPDs are local monopolists and have no competition at all from other MVPDs for subscribers. Yet competition from DBS and other MVPDs limits, at least to some extent, a cable operator's ability to force programmers to accept low prices.[124] Waterman's model also fails to reflect other realities of the programming market by assuming that negotiations are simultaneous, that there is complete information about pricing, and that the profit split between programmers and MVPDs is fixed and not subject to later renegotiation.

34. Bargaining Theory: Because of its ability to incorporate the key market-specific and transaction-specific factors that typically characterize negotiations for the purchase of programming,

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[119] *See, e.g.*, AT&T Comments to *2001 Further Notice* at 42-45, Ordover Decl. at ¶¶ 66-67, 70-71.

[120] *See* Letter from Richard Ramlall, Sr. Vice President, External and Regulatory Affairs, RCN Corp., to Chairman Martin and Commissioners Adelstein, Copps and Tate in MB Dkt. No. 05-192, at 6, transmitted by letter from Jean Kiddoo, Bingham McCutchen to Marlene H. Dortch, Secretary (May 19, 2006) ("Programmers currently impose restrictive confidentiality and non-disclosure requirements on their contracts which foreclose other buyers from knowing whether the rates, terms and conditions offered them are consistent with the rates, terms and conditions provided to affiliated multichannel video programming distributors (MVPDs) and larger competitors.").

[121] Comcast Comments to *2005 Second Further Notice* at 71-72.

[122] *Id.* at 70.

[123] Comcast Reply Comments to *2005 Second Further Notice*, Ordover and Higgins Decl. at 7-8.

[124] *See Id.* at 8-9.

bargaining theory may be better able than monopsony theory to describe and model the programming market. We determine that bargaining theory does identify some of the harms likely to occur from the exercise of market power by a large cable operator. In particular, bargaining theory points out that even if both parties have an incentive to negotiate an agreement, and both parties would benefit from an agreement, bargaining can break down if there is asymmetric information (i.e., uncertainty about the cost of the network and its value to consumers), resulting in the programmer failing to gain carriage.[125] Thus the rules we craft to ensure the flow of programming must take into consideration the possibility that a network valued by consumers will fail to gain carriage. In addition, bargaining theory shows that a cable operator with greater bargaining power can obtain lower prices than it would otherwise.[126] This would have the effect of reducing programmers' incentive to enter the market and to invest in high-quality programming.[127]

35. We find, however, that bargaining theory is not useful for setting a horizontal limit, because it cannot be applied specifically to determine at what particular level of concentration these harms are likely to occur. The results of the models used in bargaining theory are very sensitive to the particular circumstances of the transaction. Thus, whether or not a particular programming network is carried depends on a variety of factors specific to its negotiations with each cable operator. This makes it difficult to develop market-wide results relating market concentration and the general flow of programming using a theoretical bargaining model.[128] Indeed, no commenters have proposed a reliable means of using bargaining theory to determine the horizontal limit needed to prevent the harms identified.

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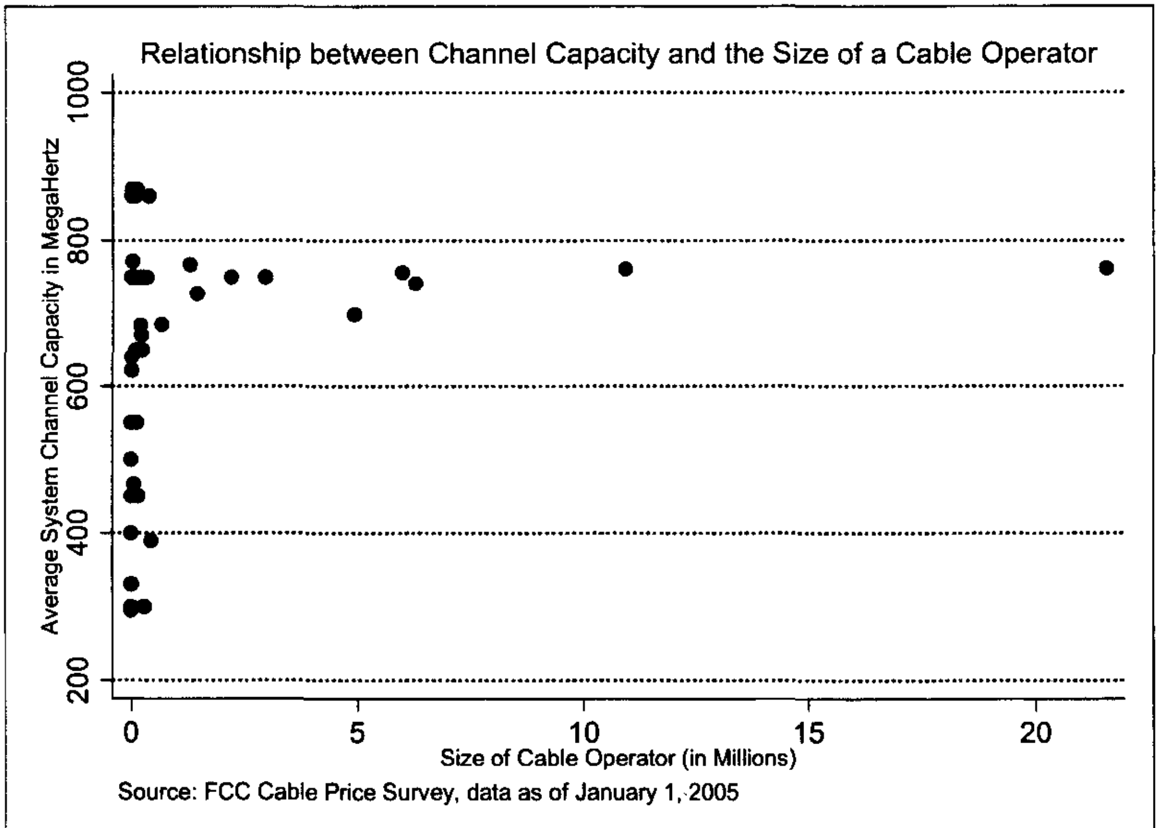
[125] *2005 Second Further Notice*, 20 FCC Rcd at 9424 ¶ 95, n.341. *See supra* note 115 (discussing the Myerson-Satterthwaite theorem). We note that there are numerous examples of popular networks not gaining carriage because of a breakdown of negotiations, such as MASN failing to get carriage on Comcast in Washington, D.C. in 2005, and YES not getting carriage on Cablevision in New York in 2002. *See Applications for Consent to the Assignment and/or Transfer of Control of Licenses Adelphia Communications Corporation, (and subsidiaries, debtors-in-possession), Assignors, to Time Warner Cable Inc. (subsidiaries), Assignees; Adelphia Communications Corporation, (and subsidiaries, debtors-in-possession), Assignors and Transferors, to Comcast Corporation (subsidiaries), Assignees and Transferees; Comcast Corporation, Transferor, to Time Warner Inc., Transferee; Time Warner Inc., Transferor, to Comcast Corporation, Transferee*, 21 FCC Rcd 8203, 8286 ¶ 186 (2006) ("*Adelphia Order*"); *News Corp.-Hughes Order*, 19 FCC Rcd at 539, 546 ¶¶ 140, 158.

[126] *2005 Second Further Notice*, 20 FCC Rcd at 9423 ¶ 93. Comcast's argument that consumers will benefit from the cable operator's ability to lower its costs only holds in particular circumstances. *See supra* ¶ 24; Comcast Comments to *2005 Second Further Notice* at 67, 74. Consumers may not benefit if the reduced costs are not passed through, or if the cable operator uses its bargaining power to exclude competitors from obtaining the network. *See Adelphia Deal May Cut Time Warner's Programming Cost, but Not Consumer's Bills*, NEW YORK TIMES, July 31, 2006, at C6 (it is not guaranteed that lower programming costs are passed through to consumers). The economics literature suggests that if prices are non-linear (i.e., where there is a non-constant relationship between price and quantity), increases in the bargaining power of a cable operator relative to that of a programmer may make consumers worse off. *See* Leslie Marx & Greg Shaffer, *Upfront Payments and Exclusion in Downstream Markets* RAND J. OF ECON. (forthcoming 2007) (available at http://faculty.fuqua.duke.edu/~marx/bio/papers/upfront.pdf).

[127] We note that it is not clear that cable operators pass on their lower programming costs to consumers in the form of lower subscription prices. *See, e.g., Adelphia Deal May Cut Time Warner's Programming Cost, but Not Consumer's Bills*, NEW YORK TIMES, July 31, 2006, at C6.

[128] Monopsony theory, on the other hand, does provide in principle such a link between market concentration and harms. As discussed above, we have determined that the traditional monopsony models do not appropriately describe the programming market, and therefore are not useful for our analysis. *See supra* ¶ 13 (stating that the *BKS Study* did not model some potentially important aspects of the industry [i.e., vertical integration, retail competition from DBS, entry into and exit from the cable network programming industry, or differences in MFN agreements across different-sized buyers]).

36. Horizontal Limit Concerns: We reject the proposition that a horizontal limit will reduce carriage of cable networks. Erdem, Katz and Morgan contend that an ownership cap will likely reduce the largest cable operator's investment in system capacity and therefore increase the probability that cable networks will fail to obtain widespread carriage.[129] They hypothesize that larger cable operators will invest in cable systems with greater capacity. They conclude that a limit on the size of the operator will increase the probability that cable networks will fail to gain widespread carriage. We disagree. As the following graph illustrates, once cable operators exceed one million subscribers, there is very little change in the average capacity of their cable systems.[130] Thus, we have no reason to believe that an increase in the size of the largest cable operator would lead to an increase in the system capacity of that operator. In fact, as the graph indicates, the average system capacities of the largest cable operators do not exceed the average system capacities of some of the smaller cable operators.



37. We are not persuaded that a horizontal cap will prevent cable operators from realizing economies of scale. Erdem, Katz, and Morgan argue that an ownership limit would check the realization of economies of scale and therefore deprive consumers of the lower prices and higher quality that would be associated with the economies of scale.[131] However, commenters do not provide any evidence that incremental economies of scale are likely to exist for cable operators that exceed the ownership limit. If

[129] Comcast March 16, 2007 Further Supp. Comments, Erdem, Katz, and Morgan Decl. at 34-35.

[130] Data from 2006 Cable Price Survey. *Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992, Statistical Report on Average Rates for Basic Service, Cable Programming Service, and Equipment*, 21 FCC Rcd 15087 (2006).

[131] Comcast March 16, 2007 Further Supp. Comments, Erdem, Katz, and Morgan Decl. at 64-65.

national subscriber reach above 30 percent were an important factor to cable operators to achieve economies of scale, we would expect to see multiple cable operators at or near 30 percent subscriber reach. Instead, however, we see many cable operators with far fewer subscribers and only one operator with a near 30 percent subscriber reach.[132] Furthermore, to the extent that these economies of scale are realized not through the number of total subscribers a cable system serves, but rather through increased clustering of cable systems in given areas, the ownership limit does not curb cable operators' ability to cluster their systems, because we have not placed any limits on the size of a cable operator in specific geographic locations.

38. NCTA argues that a horizontal cap will put cable operators at a disadvantage in competing with the largest telephone companies, including AT&T and Verizon, for offering telephony, Internet, and video programming services ("the triple play").[133] We do not believe that the ownership limit places cable operators at a significant disadvantage relative to large telephone companies such as AT&T and Verizon. As of June 2006, AT&T, the largest LEC, provided 35.2 percent of the end-user switched access lines in the United States, while Verizon, the second largest LEC, provided 23.8 percent of lines.[134] We expect the market share of these companies to decline due to the increased competition in the telephony segment.[135] The largest cable operators and telephone companies are evenly matched in terms of the number of broadband subscribers they serve.[136] With respect to telco entry into the MVPD market, their current plans suggest that they will pass fewer homes than the number of subscribers of the largest cable operator.[137]

39. We also disagree with the conclusions that Hazlett derives from his econometric analysis of the revenues of cable programming networks. The analysis purports to show that past increases in size of the largest cable operator have not been associated with a statistically significant decline in licensing fees obtained by cable programming networks, and, therefore, further increases in size are unlikely to cause any harm to cable programming networks' revenues.[138] Since the Commission began tracking cable operators' ownership statistics in 1996, no cable operator has served more than 30 percent of all MVPD

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[132] *See* Relationship between Channel Capacity and the Size of a Cable Operator, *supra* chart following ¶ 36.

[133] NCTA March 16, 2007 ex parte at 5-6. In NCTA's filing, it refers to Regional Bell Operating Companies ("RBOCs"), but we refer to them as Local Exchange Carriers or "LECs."

[134] *Local Telephone Competition: Status as of June 30, 2006*, released January 31, 2007 (available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-270133A1.pdf) and *Selected June 30, 2006 Data Filed for the Incumbent Local Exchange Carrier Operations of the Regional Bell Operating Companies* (available at http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/RBOC_Local_Telephone_June_2006.xls). For the purpose of this calculation, the end-user switched access lines for AT&T and BellSouth have been aggregated in order to estimate the post-merger size of AT&T. *See In the Matter of AT&T Inc. and BellSouth Corp., Application for Transfer of Control*, 22 FCC Rcd 5662 (2007).

[135] AT&T reports that "operating income continued to be pressured by access line declines due to increased competition, as customers disconnected both primary and additional lines and switched to competitors' alternative technologies, such as wireless, VoIP and cable for voice and data." AT&T Inc. SEC Form 10-Q for the quarterly period ended June 30, 2007 at 23.

[136] AT&T has 13.3 million broadband customers, Comcast has 12.4 million customers, Verizon has 7.7 million customers, and Time Warner has 7.2 million customers. *2nd Quarter 2007 Wrap-Up*, The Bridge Vol. 35, No. 6 (August 28, 2007) (available at http://www.thebridgemediagroup.com/media/archives/2Q_BR082807.pdf).

[137] AT&T's U-verse video service is projected to pass 18 million homes by the end of 2008 and Verizon's FiOS video service is projected to pass up to 15 million homes by 2009. *Standard & Poors Industry Surveys, Broadcasting, Cable, & Satellite*, June 14, 2007.

[138] Comcast March 16, 2007 Further Supp. Comments, Hazlett Decl. at 18-21.

subscribers, so we would expect to find no harmful effect so far.[139] Hazlett's focus on the more successful programming networks in this econometric analysis, his financial event study, and his discussion of examples of cable network formation provided later in his study are also likely to bias his results, because his analysis does not reflect the experiences of less-successful cable networks.[140] His reliance on cable network licensing fees and profits as a measure of the openness of the market also fails to account for other factors that speak to the ability of a single cable operator to force a network to exit from the market in the first five years of its existence.

C. Establishing the Horizontal Limit

40. In this section we calculate the ownership limit using the modified open field approach. The resulting limit will ensure that no single operator can, by simply refusing to carry a programming network, cause it to fail. The individual elements of this approach account for the factors that govern a network's ability to obtain subscribers. The basic building block of the calculation is the minimum viable scale of a program network. This value represents the minimum number of subscribers a programming network requires in order to be viable. Because not all of an MVPD's subscribers receive access to all of the networks carried by the MVPD, the minimum viable scale must be modified to determine how many of an MVPD's subscribers will also be subscribers to the program network. The subscriber penetration rate is used to make this determination. The resulting value is the total number of subscribers, to MVPDs that carry the network, necessary in order for the program network to serve the minimum viable scale. This value is then expressed as a percentage of the total number of MVPD subscribers to determine the fraction of the MVPD market that must agree to carry the program network so that it can serve the minimum viable scale. If there is no coordinated denial of carriage by MVPDs, this value would represent the open field necessary to give a program network a reasonable chance of serving the minimum viable scale.[141] Expressed as a formula, the ownership limit under the open field approach is:

$$Limit = \left(1 - \frac{MVS}{Pen} \cdot \frac{1}{Subs}\right)$$

[139] *See Implementation of Section 19 of the 1992 Cable Act, Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, 1996 Video Competition Report*, 12 FCC Rcd 4358 (1997); *1997 Video Competition Report*, 13 FCC Rcd 1034 (1998); *1998 Video Competition Report*, 13 FCC Rcd 24284 (1998); *1999 Video Competition Report*, 15 FCC Rcd 978 (2000); *2000 Video Competition Report*, 16 FCC Rcd 6005 (2001); *2001 Video Competition Report*, 17 FCC Rcd 1244 (2002); *2002 Video Competition Report*, 17 FCC Rcd 26901 (2002); *2003 Video Competition Report*, 19 FCC Rcd 1606 (2004); *2004 Video Competition Report*, 20 FCC Rcd 2755 (2005); *and 2005 Video Competition Report*, 21 FCC Rcd 2503 (2006). Hazlett's results on the effect of the market share of the largest MSO on the revenues of programmers are mixed. He finds that there is a negative effect, so that an increase in the size of the largest MSO depresses the revenues of programmers. Comcast March 16, 2007 Further Supp. Comments, Hazlett Decl at 21. However, the effect is not statistically different from zero at the reported levels of significance. The information, as presented by Hazlett, does not allow us to determine if the estimated magnitude of the impact would be financially significant to programmers. One possibility is that the estimated impact is financially significant, though the estimate is imprecise and therefore is not statistically significant. It would be preferable to have had the estimated impact expressed as a percentage of the revenue of programmers in order to determine whether this study merits additional study.

[140] This is the concern raised by Erdem, Katz, and Morgan regarding the *Network Survival Study*. Comcast March 16, 2007 Further Supp. Comments, Erdem, Katz, and Morgan Decl. at 36. While the *Network Survival Study* does include a substantial number of unsuccessful networks, Hazlett provides no indication that any failed networks are included in his sample.

[141] An allowance for coordinated action by MVPDs is also possible. This is implemented by dividing the open field by the number of MVPDs that are likely to engage in coordinated denial of carriage.

Three values are required in order to calculate the ownership limit: (1) total MVPD subscribers ("*Subs*"), (2) the minimum viable scale ("*MVS*"), and (3) the subscriber penetration rate ("*Pen*"). As described below, the resulting calculation indicates that an open field of 70 percent and an ownership limit of 30 percent are necessary to ensure that no single cable operator is able to impede unfairly the flow of programming to consumers.

1. Total Subscribers

41. The Commission originally calculated the ownership limit in terms of the fraction of cable homes passed.[142] In 1999, the Commission changed the methodology to use total MVPD subscribers in calculating the limit in order to account for the large and growing presence of competitors, particularly DBS.[143]

42. CFA contends that if the Commission chooses to continue using all MVPD subscribers in the calculation, DBS subscribers should be discounted by 10 percent to account for the reduced advertising revenues associated with carriage on DBS.[144] CFA notes that DBS draws more of its customers than cable does from rural markets, which are less valued by advertisers. The National Hispanic Media Coalition ("NHMC") supports the use of only cable subscribers in the calculation.[145] Comcast, on the other hand, suggests that the existing methodology fails to capture other relevant distribution outlets for video programming, such as international markets, the Internet, mobile phones, video on demand, digital video recorders, and home video sales and rentals.[146]

43. We will continue to use all MVPD subscribers when calculating the cable ownership limit. We estimate that as of June 2006, there were 95,784,478 total MVPD subscribers.[147] By including all MVPD subscribers, we account for the impact of the dynamic nature of the MVPD market on the viability of programming networks. DBS has grown dramatically since the Commission first established a limit in 1993. The recent entry of incumbent LECs into the MVPD marketplace may also have a significant effect on the role that cable operators play in the distribution of video programming. Programming networks can gain subscribers not only through distribution by cable operators but also through distribution by DBS operators and other MVPDs. The importance of taking these developments into account can be seen by comparing the maximum allowable size of a cable operator using total cable subscribers instead of total MVPD subscribers. If the limit were based solely on cable subscribers, the permitted maximum size of a cable operator would have been reduced from about 20 million subscribers in 2001 to about 19.6 million in 2005. In contrast, under a limit based on MVPD subscribers, the

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[142] *1993 Second Report and Order,* 8 FCC Rcd at 8576 ¶ 24.

[143] *1999 Cable Ownership Order*, 14 FCC Rcd at 19110 ¶ 27.

[144] CFA Comments to the *2005 Second Further Notice* at 69.

[145] *See* NHMC Comments to *2005 Second Further Notice* at 1 (evaluating the "current cable situation" in terms of numbers of cable subscribers served by major cable operators because it considers the two largest cable operators to be gatekeepers that determine the success of programming networks).

[146] *See* Comcast Comments to the *2005 Second Further Notice* at 22-34. *See also* Comcast Supp. Comments at 7-9; NCTA March 16, 2007 *ex parte* letter at 4.

[147] In the formula above, all MVPD subscribers will be used as the value for "Subs." Sources for individual elements are: (1) NCTA Comments in MB Docket No. 06-189 at 9; (2) Kagan Media Research, Media Trends 2006 at 64; (3) *C-Band Numbers Keep Dwindling, Satellite Business News FAXUpdate*, July 7, 2005; (4) The DIRECTV Group, Inc., SEC Quarterly Report Form 10-Q Pursuant to Section 13 or 15(d) of the Securities Act of 1934 for the Quarterly Period Ended June 30, 2006, at 31, (4) EchoStar Communications Corp., SEC Quarterly Report Form 10-Q Pursuant to Section 13 or 15(d) of the Securities Act of 1934 for the Quarterly Period Ended June 30, 2006, at 28; and (5) Commission estimates based on the Broadband Service Providers Association Comments in MB Docket No. 06-189 at 6. *Id. at* 2617-18 App. B, Table B-1.

maximum size of a cable operator would have increased slightly from about 25.8 million subscribers in 2001 to about 28.3 million in 2005. If the cap were based solely on cable subscribers, an operator at the limit would have had to divest subscribers at the very time it was facing increased competition and programmers were finding more distribution outlets open to them. Clearly a calculation using only cable subscribers would fail to address the dynamic nature of competition in the MVPD market by failing to account for significant MVPDs other than cable, whose market shares continue to grow.

44. We do not include mobile phones, the Internet, home video rentals, or international distribution in the total subscriber count. There is scant evidence in the record whether and how these alternative outlets affect the viability of a cable programmer.[148] Moreover, many of these alternative outlets operate based upon the existing popularity of the content, which is gained only through widespread distribution via MVPDs. Finally, including these types of outlets could result in double-counting or triple-counting the same consumers.

45. We reject CFA's suggestion that we discount DBS subscribers.[149] We note that the survival analysis used to develop the minimum viable scale of a programming network includes DBS, and other MVPD competitors, as outlets for programming. Thus, the survival analysis accounts for any impact of DBS on the viability of networks, including the effects of DBS distribution patterns or product characteristics, or any effect related to advertising differentials. Moreover, even assuming that DBS yields a lower advertising rate, it is not clear that DBS subscribers would always be less valuable to all programming networks. DBS carriage enables a programming network to serve subscribers in all parts of the country through a single provider, an advantage that may partially or completely offset the drawback of receiving a lower advertising rate. Discounting DBS subscribers would also represent a partial return to the Commission's pre-1999 methodology and run counter the court's admonition in *Time Warner II* that the Commission should account for the effect of DBS in constraining cable operators' market power.[150] As the court noted, the growth of DBS subscribership, although it has slowed in recent years, remains consistently faster than growth in cable subscribers.[151]

46. CFA maintained in response to the *2001 Further Notice* that the Commission should establish the limit as a percentage of cable homes passed.[152] CFA asserts that the statutory language calls for horizontal limits on the number of subscribers a cable operator is "authorized to reach." According to CFA, "[e]very home to which a cable operator can deliver service is a home which a franchised operator is 'authorized to serve.' Limiting the count to those who purchase the service ignores a large number of customers the operator is 'authorized to reach'."[153] Comcast proposes that the Commission include every American household in the denominator because it contends that DBS passes every home in the U.S.[154]

[148] As discussed in the calculation of the minimum viable scale, however, the calculation does account for the effect of alternative revenue sources on network program viability. *See infra* ¶ 52. *See also* MAP March 21, 2007 *ex parte* letter at 2 (stating that DVDs and video iPods do not increase the availability of independent programming channels that would otherwise support new networks).

[149] *See* CFA Comments to the *2005 Second Further Notice* at 68-70.

[150] Addressing petitioners' arguments that the Commission failed to adequately account for competitive pressures from DBS, the D.C. Circuit stated that "in revisiting the horizontal rules the Commission will have to take account of the impact of DBS on that market power." *Time Warner II*, 240 F.3d at 1134. For a further discussion of the competitive effect of DBS, *see infra* ¶ 70.

[151] *Time Warner II*, 240 F.3d at 1133 (citing *2000 Video Competition Report*, 16 FCC Rcd 6005, 6008 at ¶¶ 6-8).

[152] Consumer Federation of America, Consumers Union, the Center for Digital Democracy, and the Media Access Project, CS Docket No. 98-82, et al. (Oct. 11, 2002) (CFA Oct. 11, 2002 *Ex Parte*).

[153] *Id.* at 4.

[154] Comcast Supp. Comments at 27-28.

47. We do not agree that the statute mandates adoption of a homes-passed standard for the calculation of the horizontal limit. Indeed, the Commission has already considered and rejected this approach.[155] Section 613(f)(1)(A) requires the Commission "to prescribe rules and regulations establishing reasonable limits on the *number of cable subscribers* a person is authorized to reach" through cable systems owned or attributed to such person.[156] Neither the statute nor the underlying legislative history requires a "homes passed" standard, and the Commission is not precluded from adopting a subscriber-based standard.[157]

48. As NCTA points out and we have recognized, cable operators negotiate with and purchase programming from video programmers based on the actual number of subscribers they serve, not the estimated number of homes passed within their franchise areas.[158] Therefore, cable operators' share of actual subscribers nationwide more accurately reflects their market power in the video programming market than the homes passed standard – using either cable homes passed or DBS homes passed. Moreover, in terms of "market structure," the Commission observed that although the breadth of cable operators' reach in terms of homes passed might be wide, their actual penetration in terms of homes served may be much lower, rendering the homes passed criterion an inaccurate measurement of their market power.[159] In view of DBS's current nationwide reach and the presence of cable overbuilders passing the same homes as cable, the homes passed standard not only has come to represent an inaccurate indicator of market power, it has become an unworkable standard.[160] As the same homes are passed by more than one MVPD, the homes passed standard inevitably results in double counting and renders it impossible to determine a cable operator's market share. A subscriber-based standard is a more accurate indicator of cable operators' size and market power in a dynamic and evolving communications marketplace. The adoption of the subscriber-based standard is consistent with and supports our decision to include the total MVPD subscribership in the calculation of the horizontal limit.

2. Minimum Viable Scale

49. In 1999, based upon an examination of the number of subscribers that successful networks had acquired, as well as industry comments, the Commission calculated that the minimum viable scale of a programming network was on the order of 15 million subscribers.[161] In 2005, the Commission sought

[155] *Implementation of Sections 11 and 13 of the Cable Television Consumer Protection and Competition Act of 1992, Horizontal and Vertical Ownership Limits, Cross-Ownership Limitations and Anti-Trafficking Provisions*, 8 FCC Rcd 210, 217 ¶ 36 (1992) (stating that "the Commission may prescribe subscriber limits either as a share of cable subscribers or as a share of homes passed," since the 1992 Act does not define the term "reach" in the context of subscriber limits).

[156] 47 U.S.C. § 533(f)(1)(A)(emphasis added).

[157] NCTA suggests that the provision "authorized to reach," which the statute does not define, may be interpreted "simply means that the Commission is required to set limits on the number of subscribers a cable operator is 'permitted to serve' through owned and affiliated cable systems." NCTA Feb. 18, 2000 Opposition at 4. Language in the *Conference Report* supports the "permissive interpretation" NCTA suggests. The *Conference Report* states, in pertinent part, that: The Senate bill amends 613(f) of the Communications Act as follows: Subsection (f)(1) requires the FCC to establish reasonable limits on (A) the number of cable subscribers that any one cable operator may serve through cable systems owned by the operator or in which the operator has an attributable interest. H.R. Rep. No. 102-862 at 81 (1992) (*Conf. Rep.*); *see also Senate Report* at 80.

[158] *See* NCTA Feb. 18, 2000 Opposition at 6; *Sixth Annual Report*, 15 FCC Rcd at 1056 ¶ 175 and n.629; *1999 Cable Ownership Order*, 14 FCC Rcd at 19108 ¶ 22.

[159] *See 1999 Cable Ownership Order*, 14 FCC Rcd at 19108 ¶ 22.

[160] *See id* at 19108-09 ¶¶ 22-23; NCTA Oct. 23, 2002 *Ex Parte* at 2.

[161] *1999 Cable Ownership Order*, 14 FCC Rcd at 19115 ¶ 41.

comment on the number of subscribers a programming network requires in order to remain viable.[162] The Commission proposed that viability is partly a function of the time the network has been in the market, and that simply because recently-launched networks tend to have a limited number of subscribers early in the launch, does not mean that those networks will remain viable in the future with a limited number of subscribers.[163] Referring to the comments of programmers that were submitted in other proceedings, the Commission suggested that long term viability may require more than 40 million subscribers.[164]

50. Comments filed in response to the *2005 Second Further Notice* reflect a wide range of viability estimates. CFA, for example, states that increased programming costs necessitate that a network serve 50 to 75 million subscribers in order to reach long-run viability.[165] TAC asserts that there are two requirements for a new network to enter and survive in the marketplace: the ability to forecast distribution to 50 million households over five to seven years and access to the top television markets.[166] TAC contends that in order for a network to reach the survivability target of 50 million subscribers, a network first must reach the 20 million subscriber mark to obtain reliable Nielsen data.[167] It states that networks that cannot provide advertisers with reliable ratings data are extremely limited in their ability to generate ad revenue and will not survive in the market.[168] Observing that all of the cable networks with distribution to 25 million households or more are carried by both Comcast and Time Warner, TAC asserts that in order to exceed 25 million subscribers, a network must be carried by both MSOs.[169] TAC estimates that there is an open field of 53.4 million subscribers a network could reach without carriage by Comcast or Time Warner.[170]

51. NCTA contends that it is not possible to calculate a single value for the minimum viable scale of a network, asserting that even if the Commission were to calculate the average number of subscribers needed for a network to be viable, the calculation would be imprecise.[171] Erdem, Katz and Morgan argue that the average network may not be representative of the population of networks or

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[162] *2005 Second Further Notice*, 20 FCC Rcd at 9414-20 at ¶¶ 74-84.

[163] *Id.* at 9415-16 ¶¶ 75-76.

[164] *Id.* at 9418-19 ¶ 82.

[165] CFA Comments to the *2005 Second Further Notice* at 10-11.

[166] TAC Comments to the *2005 Second Further Notice* at 13-18. According to CFA, the Commission should assign an advertising-weighted premium to the subscribers in the top markets when reviewing a specific transaction. CFA contends that without that adjustment, the "true market power of top-market clusters will be ignored to the detriment of consumers and programmers." CFA Comments to the *2005 Second Further Notice* at 68-70.

[167] TAC Comments to the *2005 Second Further Notice* at 20.

[168] *Id.*

[169] *Id.* at 21. TAC also emphasizes that of 92 national, non-premium cable programming networks that have succeeded in reaching 20 million households, "not a single one had achieved the 20 million household milestone without carriage by either Comcast or Time Warner, or both." *Id.* at 20.

[170] *Id.* at 21-22. TAC states, however, that if a network is denied carriage by both Comcast and Time Warner, it would need to be carried by every other MVPD and added to their basic analog tiers to reach the 50 million subscribers that advertisers require. In addition, TAC provides data suggesting that of 114 independent networks seeking national carriage, none has launched without carriage by Time Warner or Comcast, and the total numbers of independent networks actually launched are low. Id. at 22-23, 35-37. TAC defines "Independent Network" and "Unaffiliated Network" as "any Network without financial ties to Comcast, Time Warner, Viacom, News Corp, NBC Universal, Disney, or their subsidiaries." *Id.* at 34 n.46. TAC states that if Time Warner or Comcast deny carriage of a network, other cable operators will be less willing to dedicate channel capacity, marketing, and other resources to distribute the network because its survivability is in doubt. *Id.* at 22-23.

[171] NCTA Comments to the *2005 Second Further Notice* at 14.

potential networks.[172] They also question the public policy rationale of protecting networks' decisions to follow a high-cost strategy.[173] Comcast maintains that the minimum viable scale of a network is much lower than that suggested by other commenters and asserts that networks can launch and remain operational with far fewer than 40 to 60 million subscribers.[174] Comcast provides several examples of national programming networks that it claims are thriving with fewer subscribers, specifically, Bloomberg Television (34.1 million subscribers), DIY (31 million), Fine Living (25 million), Independent Film Channel (34.6 million), Fuse (36.8 million), and NFL Network (24 million).[175] In addition, Comcast asserts, the data supporting the Commission's 15 million subscriber threshold is outdated and unreliable, given the rapidly changing video programming marketplace.[176] Comcast states that many successful networks, including regional programming networks, serve fewer than 15 million subscribers.[177] Comcast adds that the video programming market is moving toward niche services that target specific demographics and do not require mass market distribution. Comcast also notes that the *Media Bureau Survival Study* indicates that "a network requires only 10.18 million subscribers from day one to have a survival probability of 70 percent over the first five years, and 13.94 million subscribers from day one to have a survival probability of 70 percent over its first ten years."[178] In response to TAC's arguments, Comcast contends that the absence of other programming networks as participants in the proceeding suggests that "programmers do not believe that horizontal or vertical cable ownership rules are necessary to ensure the flow of video programming to consumers."[179] Comcast disputes TAC's argument that independent programmers cannot obtain carriage from other MSOs without carriage by Time Warner and Comcast.[180] Hazlett provides a number of examples of independent programming networks that have successfully entered the market, some without carriage from the largest cable operators, or are planning on entering the market, as evidence that market participants still believe that entry is feasible for an independent network.[181]

52. In order to determine the minimum viable scale (MVS) of a programming network for

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[172] Comcast March 16, 2007 Further Supp. Comments, Erdem, Katz, and Morgan Decl. at 33.

[173] *Id.* at 33-34.

[174] Comcast Comments to the *2005 Second Further Notice* at 75.

[175] *Id.*

[176] Comcast Supp. Comments at 11.

[177] Comcast Comments to the *2005 Second Further Notice* at 75-76. Comcast provides a list of 52 networks, including launch dates, that have fewer than 15 million subscribers. Comcast April 4, 2007 *ex parte*, at 3-4, App. A.

[178] Comcast Comments to the *2005 Second Further Notice* at 78-79. AT&T claims that because advertising supports programming, networks can be viable even if they reach fewer than 15 million MVPD subscribers. AT&T Comments to the *2001 Further Notice*, Besen Decl. at ¶ 3. More generally, AT&T asserts that the open field approach assumes that all services need the same size open field to achieve viability, when in reality the open field requirement is highly individualized and depends on the unique characteristics of each programming package. *Id.* at 62-65; *see also id.* at Besen Decl. at ¶¶ 3, 11, 14.

[179] Comcast Reply Comments to the *2005 Second Further Notice* at 5.

[180] Comcast asserts that its decisions to carry programming are based on the content and theme of the network, the necessity or desirability of its presentation as a linear network, the financing of the network, the experience and proven capability of the management team, the distribution secured by the network elsewhere, and the fees and terms of carriage and that TAC's lack of carriage is not attributable to unfair treatment by a particular MVPD or a structural problem in the industry. Comcast Reply Comments to the *2005 Second Further Notice* at 7-8.

[181] Hazlett cites the examples of Fox News Channel, Oxygen Television, American Life TV, The NFL Network, CSTV Networks, and The Sportsman's Channel as independent networks that have entered recently. Comcast March 16, 2007 Further Supp. Comments, Hazlett Decl. at 30-35.